Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Alarcon	Analyst:	Jeff Garnier	Bill Number:	SB 2037
Related Bills:	See Legislative History	Telephone:	845-5322	Introduced Date:	February 25, 2K
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Environmental Building Costs Credit

SUMMARY

Under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL), this bill would allow a credit equal to 5% of environmental building costs paid or incurred to construct, repair, maintain, rehabilitate or improve a commercial or multifamily residential structure.

EFFECTIVE DATE

As a tax levy, this bill would become effective immediately upon enactment and would apply to taxable and income years beginning on or after January 1, 2001.

LEGISLATIVE HISTORY

AB 2237 (2000) would allow a credit equal to an unspecified percentage of the amount of environmental building expenses (defined differently than this bill) expended on buildings and other structures.

SPECIFIC FINDINGS

Existing state and federal laws provide various tax credits that are designed to provide tax relief for taxpayers that must incur certain expenses (e.g., renter's credit) or to influence behavior, including business practices and decisions (e.g., research credits).

Generally, under **state and federal law** the cost of erecting a building or other structure or a major improvement or repair to an existing building is considered a capital expense. If the building or structure is used in a trade or business, the costs expended must be capitalized into the cost basis of the property and deducted against income through depreciation over the useful life of the building or structure. If the building is not used in a trade or business (a personal asset), costs expended must still be capitalized into the cost basis of the property. The cost basis of a personal asset is used to determine if a taxpayer has a taxable gain upon disposition of the personal property.

Under current **state and federal law,** a repair, renovation or improvement to a building that does not increase the value of the building or extend its useful life is considered a current period expense. If the building is used in a trade or business, the expense is deducted against income in the period the expense is paid or incurred. If the building is a personal asset, the costs expended are considered personal expenses of the taxpayer and are non-deductible and cannot be capitalized.

Board Position:			Department Director	Date
______ S	______ NA	______ NP	Alan Hunter for GHG	3/30/00
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Under current practice the following state entities have informally formed the Green Building Task Force:

- The California Energy Commission.
- The Department of General Services.
- The California Waste Management Board
- The State Department of Health Services.
- the Secretary of State and consumer Services Agency.
- The Department of Finance.
- The State Air Resources Board.
- The Department of Water Resources.

This bill would allow a credit equal to 5% of the cost of environmental building costs paid or incurred to construct, repair, maintain, rehabilitate or improve a commercial or multifamily residential structure that is at least 20,000 square feet in size. Environmental building costs are defined to mean costs paid for:

- A fuel cell or photovoltaic module that provides electrical power. A fuel cell is defined as a device that produces electricity from hydrogen or hydrocarbon fuel in a noncombustible electrochemical process. A photovoltaic module must produce electricity from direct sunlight.

- A non-ozone depleting refrigerant, which is defined as a refrigerant, used in air conditioning systems, that has been determined by the Green Building Task Force not to adversely affect the earth’s ozone layer

- Any fixture, including a device, material, or mechanical, certified by the Green Building Task Force to be environmentally sound or energy efficient. (Environmentally sound means a fixture that has negative impacts on the environment less than any other product that is commonly used for the same purpose. It must be scientifically demonstrable that the certified fixture negatively impacts the environment less than other fixture commonly used for the same purpose. Energy efficient means a fixture that reduces the consumption of heat, process heat, space heating, water heating, steam, space cooling, refrigeration, mechanical energy or electricity.)

Under the Revenue and Taxation Code, **this bill** would formalize the existence of the Green Building Task Force, and require the task force to complete the certification of fixtures and the determinations related to refrigerants by July 1, 2001, and annually update the list of certifications by each July 1 thereafter.

This bill would allow any unused credit in excess of the taxpayer’s tax liability to be carried over to future years until exhausted.

Policy Considerations

This bill would allow the credit for environmental building costs for buildings located outside of California.

This bill would allow taxpayers in certain circumstances to claim multiple special tax credits for the same item of expense (e.g., Manufacturers’ Investment, Enterprise Zone and Targeted Tax Area Credits.)

In the case of buildings being used in a trade or business, this bill would not require the basis of the building or the current expense to be reduced by the amount of the credit.

Conflicting tax policies come into play whenever a credit is provided for an expense item for which preferential treatment is already allowed in the form of an expense deduction or depreciation deduction. This new credit would provide a double benefit for these expense items. On the other hand, making an adjustment to reduce the basis or expense in order to eliminate the double benefit creates a state and federal difference, which is contrary to the state's general conformity policy. In the case of a one-time expense deduction, the reduction of that expense would not create an ongoing difference. However, if the expenditure must be capitalized, then an ongoing difference would be created.

This bill does not limit the annual aggregate credit amount that would be allowed to any one taxpayer.

This bill would allow an unlimited carryover for the environmental building cost credit. Recently enacted credits have contained a limited carryover since credits typically are exhausted within eight years.

This bill does not contain a sunset date. Credits are typically enacted for four to five years to allow the Legislature to examine the effectiveness of the new credit.

This bill does not require the environmental building costs incurred by the taxpayer to be for new equipment and does not state a minimum amount of time the taxpayer must have the equipment placed in service to avoid recapture of the allowed credit. Without one of these requirements, more than one taxpayer could claim the credit on the same piece of equipment.

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact the department’s costs.

Tax Revenue Estimate

The revenue losses under the B&CT and PIT laws are estimated to be as follows:

Revenue Impact of SB 2037		
For Taxable Year Beginning After 1/1/2001		
Assumed Enactment After 6/30/2000		
Fiscal Years		
(In Millions)		
2000-01	2001-02	2002-03
-$3	-$25	-$25

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result form this proposal.

Revenue Discussion

The impact of this bill would depend upon the number of taxpayers incurring qualifying environmental building expenses, and the average credit applied against tax liabilities.

This estimate is based on actual departmental data regarding previous credits (i.e., commercial solar energy credit and the energy conservation credit) and grown to the out-years by applying the consumer price index. Adjustments were made to account for differences between this credit and previous credits (i.e., percentage of cost for the credit calculation, universe of potential taxpayers, etc.). The first fiscal year impact primarily represents reductions in estimated tax payments made by corporations.

BOARD POSITION

Pending